RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

P. O. Box 1759, La Jolla, California 92038
Minimum of 26 Letters per year — $185 Annually
Registered with the Securities and Exchange Commission

October 8, 1980 **LETTER 793**

Sept. 26, DJIA 940.10; PTI 1308; A-D Ratio –16.19
Oct. 3, DJIA 950.68; PTI 1326; A-D Ratio –16.64

THE PICTURE: The D-J Industrial Average recorded a 1980 high of 974.57 on September 22. On the same day the D-J Transports touched an all-time record high of 350.01. From there (with the help of a Mid-East war and a 1% boost in the discount rate) the Averages turned down with a vengeance. So violent was the decline that the Dow "gapped" lower on two successive days (September 26 and 29). I don't remember seeing a two-day gap in the Dow before (you can see the gaps on the chart in the WSJ).

Meanwhile, the two interest-sensitive Averages, the D-J Utilities and the D-J 20 Bonds, were sliding relentlessly. On September 29 the Utility Average broke below its August 5 low of 108.91 (see chart below). At the same time the 20-Bond Average tumbled to within 3 points of its 1980 low of 63.87.

From the Dow Theory standpoint, it is significant that last week's market sell-off saw a downside divergence. Note on the

Government Finances

WASHINGTON (AP) — Here are figures on government spending and debt (last six digits are omitted). The government's fiscal year runs from Oct. 1 through Sept. 30.

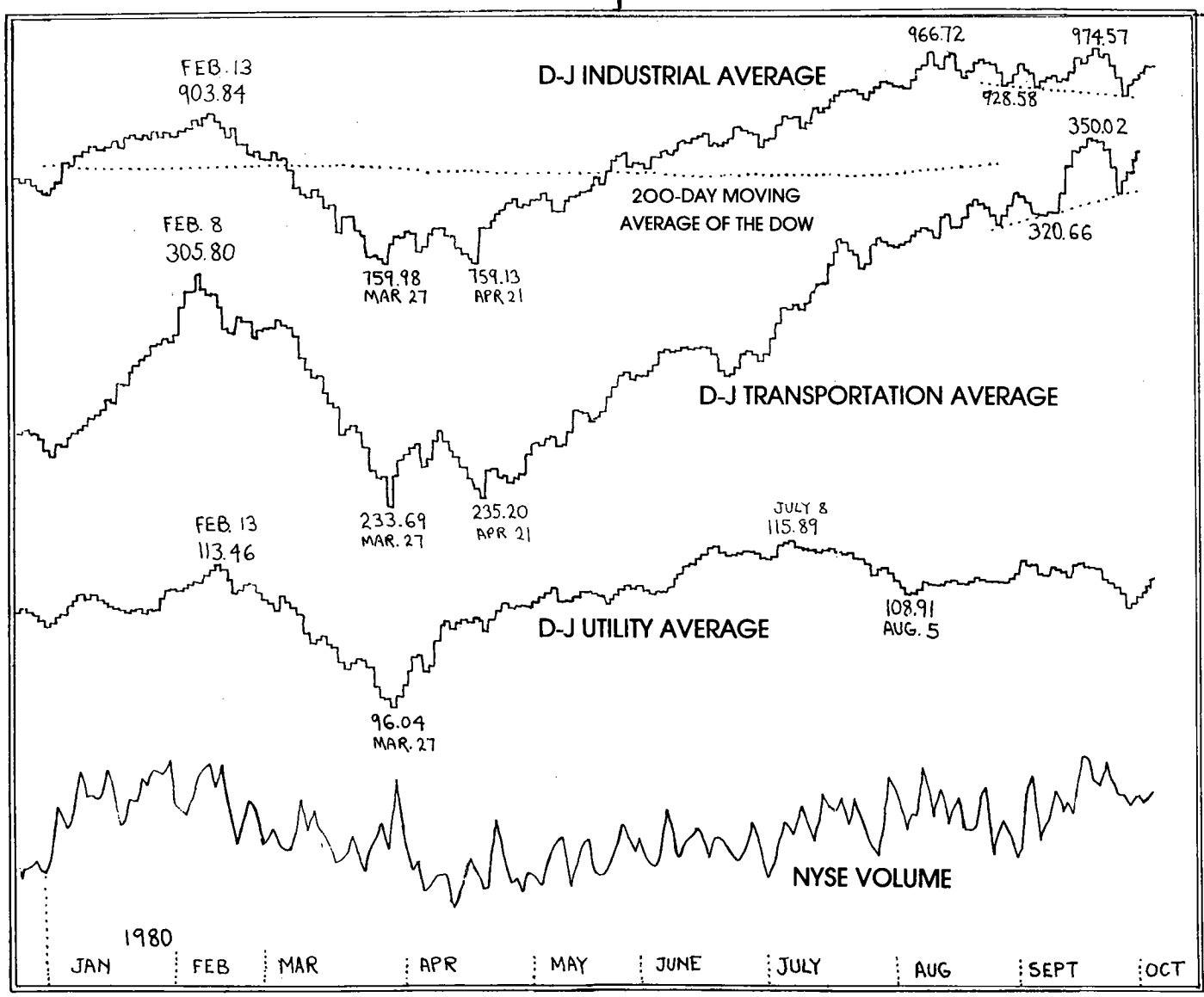
Total public debt as of Sept. 30		907,701 ←
Interest on public debt for Aug		5,585
Interest for fiscal year through	Ag	69,163 ←
Estimated budget deficit fscl	1980	60,882
Actual budget deficit last year		27,700
Receipts for fiscal yer thrgh Ag		466,506
Receipts for same period last	yr	418,653
Outlays for fiscal year thrgh	Ag	531,722
Outlays same period last year		464,064

The Administration raised its 1981 deficit estimate by 50%.

The estimate of the fiscal 1981 budget deficit by Carter Administration officials was raised to somewhere around $45 billion rather than the $29.8 billion they projected last July. The sharply higher esti-

COMMENT: Here's the latest triumph of the 1980's. This week's tabulations show the US Federal debt going over $900 billion for the first time. Interest on the debt for fiscal 1980 hit $69 billion or $1.3 billion per week! On top of that, the Administration has just raised its estimate on the 1981 deficit to $45 billion. My estimate—nearer $75 billion.

(continued on page 2)



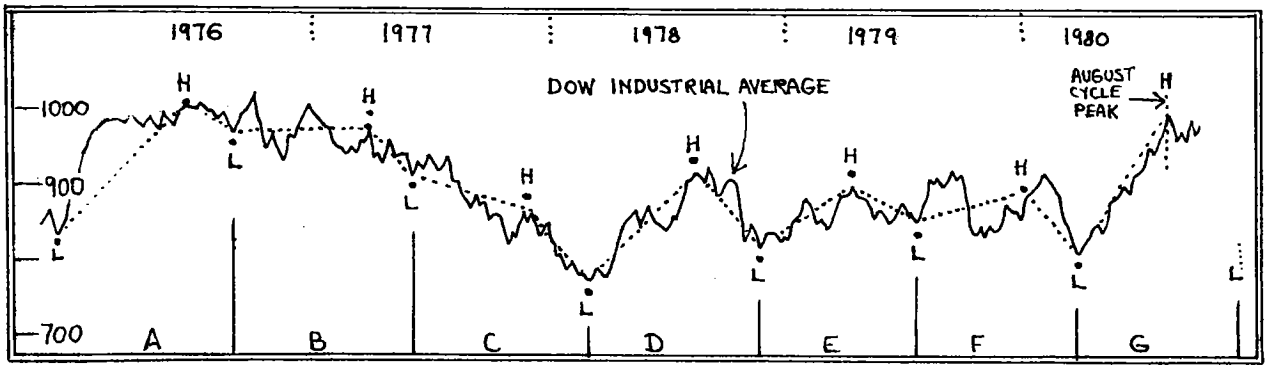
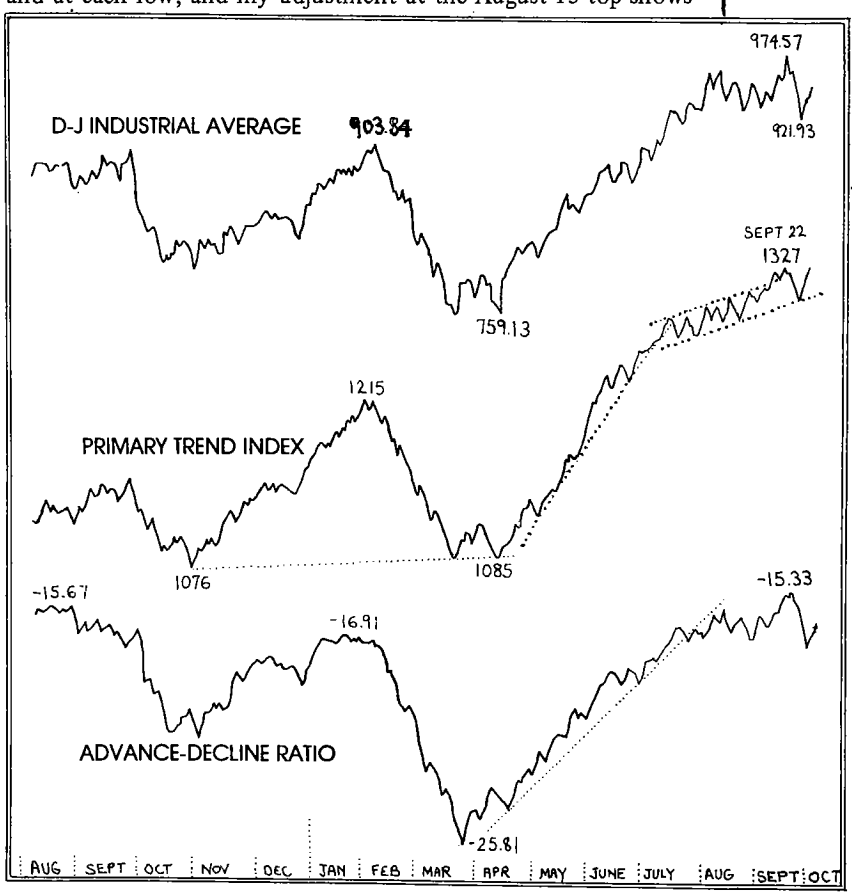


chart that Industrials plunged below 928.58, but Transports held well above their comparable point (that point was 320.66). This was positive action, and it set off a rally. But any further weakness would spotlight the 320.66 level for Transports. A new low for Industrials (below 921.93) with Transports breaking 320.66 would signal trouble. In the meantime, the market has been doing well in resisting the bearish segment of the 233-day cycle (see discussion in Letter 792).

In the last Letter I presented what I thought were the four most important technical developments of the day. These were the head-and-shoulders bottom in the S&P Composite Average, the "Great Circle" pattern in the Dow, the PTI, and the 233-day market cycle.

The more immediate of the four is the action of the PTI and the 233-day cycle and I want to update these two items now. The first is the 233-day cycle (chart above). This is a cycle that I have followed for many years; I show 6 completed cycles on the accompanying chart (A through F) plus the latest cycle (G). On August 15 the bull part of the 233-day cycle was completed with a Dow closing of 966.72. I adjust the cycle at each peak and at each low, and my adjustment at the August 15 top shows



This is the picture of an economy out-of-control. It all underscored my thesis that with its mountains of debt, the US can no longer contract without bringing on disaster (the debt would eat us alive). Thus, we must "inflate or die."

The Fed in a calculated risk, raised the discount rate (Sept.25) to 11%, and this just weeks before the election. My guess is that Volcker has counted Carter a loser and figures he will do the right thing and have to deal with Reagan anyway. With mortgage money over 14%, with consumer real income 6% below last year, it's curtains for housing. And now with Detroit boosting auto prices up as high as 25% over last year, the car picture has the smell of death.

Yet the money supply has been booming, business loans have been rising, and defense spending is headed into the stratosphere. In this kind of atmosphere, there is no stability, no safety, no long-term investment policy. The battle for investment survival becomes a daily battle for retention of purchasing power, and the winner is the one who loses least.

Consider this, the winners of the last decade are the ones who have funds (borrowed or otherwise) in inflation oriented vehicles (real estate, gems, collectibles, art). But most of these vehicles are illiquid, and these same inflation-millionaires are the ones most vulnerable to a credit and price collapse. Thus, there is no peace of mind today.

that the bear segment of the cycle is scheduled to **end around November 10.**

Cycles have to do with *direction* and *duration*–not extent. In other words, the position of the 233-day cycle tells me that the directional *tendency* of this market is now down, and this directional tendency should last until about November 20 (when the down-cycle ends). Note on the chart that since 1976 the down segment of each 233-day cycle has dominated. To put it another way, the market has always declined during the bearish segments of the cycle.

The important factor now is to observe HOW the market acts during the current bear segment between August 15 and November 10. A generally strong market will tend to resist decline. A weak market will decline with a vengeance and lose better than half (in some cases all) of the previous bull segment cycle gains. The final test will come over the next 4-5 weeks. The odds, based on the action of the past four years, indicate that the market should be lower on November 10 than it was on August 15.

PRIMARY TREND INDEX: Some market advisories publish a list of technical indicators with each issue. They talk about the list as the technical "weight of evidence." Well, that's exactly what the PTI provides me with–a weight of evidence statistic. However, there are a few differences between the PTI and most of the advisory weight of evidence run-downs.

First, and this is important, the PTI is a statistic that I calculate *every day*. That means that I can watch and measure the daily build-up or decline in technical strength and this is crucially important, since patterns and trends are always in progress.

Second, for 10 years or ever since I invented the PTI, I have used the SAME technical averages and indicators. Thus, comparisons over the days, weeks and months are valid.

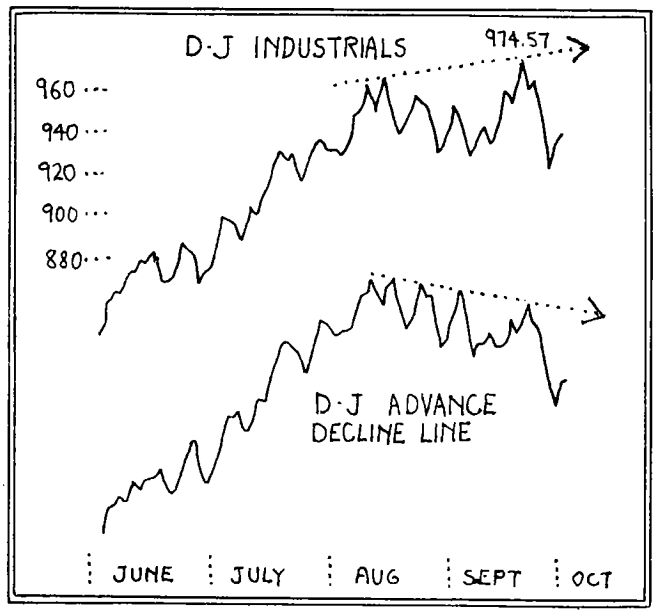
Finally, I am a believer in that old adage which states, "What everybody knows about everything of a financial nature is sifted down to the action of the market." When I first conceived of the PTI, I decided that I wanted to use only components based on **market action.** I did not want odd-lots, I did not want investor sentiment, I did not want short interest figures. I wanted only market-action components such as stock averages, bond averages, advance-decline, high-low figures, most-active stocks. I based this on the concept that market psychology can change, sentiment measurements can change, trading instruments can change (for instance, options have thrown a lot of doubts on the usefulness of the short interest statistics), but market action immediately adjusts to everything else. You can manipulate a lot of items, but the hardest thing to manipulate is the action of the market itself. The market is honest, and it's always smarter than the manipulators.

Referring to my daily chart (page 2) of the Dow, the PTI and the A-D, note that the PTI has been walking up a shallow ascending channel since July. The high for the Dow was reached on September 22 at 974.57 and this was confirmed by a new high of 1327 on the PTI. Then came the sharp break to 921.93 on the Dow. Remarkably, the PTI on this drop came down exactly to the lower trendline–and then it rallied. In all honesty, I must say that I was surprised (again) by the strength of the PTI. I was sure (given the violence of the decline) that the PTI would smash below its rising channel. It did not. The story may not be over yet, however, and it remains to be seen whether the PTI can continue to walk up the rising channel that has been in effect since July.

Remember, it not only requires a peak but a downtrend to turn the PTI bearish. By that I mean that the PTI turns bearish only when it establishes, then holds BELOW a declining trendline. That has **not** occurred at this writing.

The A-D ratio at the bottom of the page 2 chart is looking neutral to weak. The recent drop wiped out all the August and September gains. It would take an exceptional amount of market strength to better the September high, and I am therefore becoming increasingly dubious about the near-term possibilities.

The most bothersome (bearish) item in my work is the A-D line for the 30 Dow stocks. It is most unusual when the Dow A-D (the advances and declines for just the 30 Industrials) diverges from the Average. Note (see chart) the extraordinary divergence and non-confirmation that occurred during September–and then the 53 point break in the Dow. On October 1 the Dow rose 7 points and the Dow A-D was actually down 1. Thus the weakness in the Dow picture continues. All of this suggests to me that the market is wobbly, and that the down-segment of the 233-day cycle has the market in its grip.



Conclusion: Over the long term, I believe the bullish picture (S & P 500, "Great Circle") shown in the last Letter will prevail. Over the near term, the 233-day cycle will be a negative force, at least until early November. But the PTI keeps pushing up, and I continue to be impressed with it's strength and persistence. Fight it at your risk.

MONEY MARKETS: The influential Schroder Report states, "Prior to the October, 1979 Fed package, we had widely fluctuating monetary aggregates but generally moderate fluctuations in interest rates. Now we not only have widely fluctuating aggregates but widely fluctuating interest rates." The inference is clear, there's no controlling an economy with this much debt (which is potentially deflationary) and this much pump-priming (which is inflationary). Thus we now have to deal with an erratic Fed and explosive interest rate swings.

The fact is that billions of dollars have been lost in the money markets over the last few years. But one man's disaster is another man's opportunity. And somewhere ahead lies a very profitable opportunity in the bond markets (we already had one big bull move in 1980).

I watch four main sections of the money markets, the short-term Treasuries, the long-term Treasuries, the Industrial Bonds and the Municipal Bonds. All sectors tend to move together, but at major turns first one sector, then the other resists (much like the Averages in the stock market), and finally the reversal arrives.

The weak sister of the money market has been the Municipal bonds. There's no way that Muni bonds could have continued to cave in (which they have been doing for months) without taking the rest of the money market with them. And that's exactly what happened. On the week ending September 26 the D–J Municipal Bond Average continued to collapse, providing an all-time record (tax free) yield of 10.01%. Against that kind of competition, EVERYTHING in the money markets was under pressure.

Right now the Muni's are at new record lows, the Industrial bonds are close to their lows, long-term Treasuries are within a few points of their 1980 lows, and the question is: will we get a "double bottom" on most of the bonds, or are we heading for new record lows all around?

Not only is this a vital question for the stock market, but it is a vital question for the business of the nation. It is also, by the way, an important question for me and many of my subscribers who like to speculate in the bond market, particularly when bonds have suffered one of their extraordinary collapses. I've said many times that the SAFEST play in any of the markets is buying an item FOLLOWING A CRASH. The odds, following a crash, are extremely high that the ensuing advance will recoup at least half of the ground lost during the crash. And this is the play that I am waiting for in bonds.

The accompanying daily chart of the bellwether US Treasury 8's of 1996-2001 provides a clear idea of what's been happening in the bond market. As you can see, the decline has been almost as violent as the earlier recovery. But the next advance should gain at least half of the losses since the June high. And that is a profitable concept.

NOTES & QUOTES: All you old-timers have probably forgotten what goes on when you have those terrible tots. Having had three girls (ages 17 to 24), I now have boy-Ryan. So it's Spiderman and Superman and Bat Man every day. If you think that 2½ year old boys these days aren't into capes and guns and space ships, forget it. I'm greeted at any hour of the day or night with a flying Kung Fu kick or a 35 pound body suddenly dropping on my head. So if there's any blood or gore on your copy of DTL, you'll know whose blood it is – mine!

* *

According to US News and World Report (Sept. 29), *"... by a ratio of 2 to 1, members of the Democratic-controlled Congress believe ... Reagan is on the road to victory in the race for the White House."* I might as well add that I've changed my mind on the election; I too think Reagan is going to win. Carter's blatant, self-seeking, deceitful campaign has disgusted many Democrats. The total election turnout therefore promises to be substandard. Since most of the nation is Democratic, a low turnout will help Reagan. Anderson will get many liberal votes (which Carter has lost). This will also help Reagan. Furthermore, Reagan is coming over as very human and honest.

Meanwhile, the economy is working against Carter. Rising interest rates and whopping budget deficits plus inflation are bound to hit many former Carter votes. I am betting Reagan will be our next President. If ever we needed a change, this is the time. Carter has been one long, unmitigated disaster.

* *

There's no deflation in the art world yet. Last week the Whitney Museum in NYC paid $1 million for a Jasper Johns painting that sold in 1959 for $900. This was the highest price ever paid for a painting by a living artist. Meanwhile, Christie's in NYC auctioned off a van Gogh for $5.2 million. Van Gogh, in his entire lifetime, sold only a single painting. The canvas that the Whitney bought was one that van Gogh had painted for his friend, Gaugin, as a gift.

* *

You think the US–Soviet military comparison looks unfavorable? Well, what does this little clip tell you about the future? Let's just hope that the US turns out disproportionate number of geniuses over the next 20 years!

A CONTRAST IN EDUCATION

Dr. Isaac Wirszup is a member of the faculty at the University of Chicago and an expert on the educational process in the Soviet Union. According to his recently published report, 98 percent of the students who attend high school in the U.S.S.R. graduate; in the United States, 74 percent of all high school students graduate. To quality for a high school diploma in Russia the following requirements must be met:

5 years of algebra
2 years of geometry
2 years of calculus
5 years of physics
4 years of chemistry
5 years of biology
5 years of geography
3 years of mechanical drawing
1 year of astronomy

In contrast, the National Science Foundation published a study that pointed out these facts about America's 1979 high school graduates:

only 45 percent had one year of general science
17 percent had one year of biology
16 percent had one year of chemistry
9 percent had one year of physics

* *

Last night I dreamed up the "perfect inflation-survival" investment package for the 1980's (and this is no joke): Sotheby Parke Bernet (OTC), the world's largest auction firm, Sturm Ruger (OTC), the only pure gun play available, and Dome Mines, NYSE, the largest gold-oil play in the West.

From our Statistics Dept. : The Carter Administration will be the first in US history to spend over $1 billion per DAY.

* *

GOLDEN RESCUE: Consciously or unconsciously, the markets almost always sense what is coming up on the economic horizon. William Hamilton, famous Dow Theorist and Editor of the *Wall Street Journal* said it best when he wrote, *"When coming events cast their shadows before, those shadows fall on the New York Stock Exchange."*

Now I have written about the debts of the US and about world debt until I am blue in the face. And often I sit and ponder, "How the devil can the Free World get out of this unbelievable predicament?" For the fact is that somewhere ahead we are going to face a financial crisis, and that crisis will be a matter of financing the debt. Forget ever paying the debts back, it will be basically a matter of servicing the debts that we have already incurred.

Debts are now hanging heavily over the US and the whole Free World. It takes the creation of a lot of new paper money to finance the US debt (let's just talk about US debt). The figure I use is $5 trillion for total US debt. That means that about $500 billion each year must be raised just for servicing! And the cost is going up! The crisis will come when the servicing costs of the US debt (which is now compounding) are so huge that all our entire cash flow, all our profits go to servicing debt. At that point the ax falls.

But there's one interesting alternative. Let me put it this way. Say you owe $100,000. Your income is only $15,000 a year, and your accountant tells you you're broke. But you own 20 gold coins, and they're worth say $200 a piece. So you owe a whopping $100,000 and you have assets of $4,000 (those 20 gold coins). Then the price of gold starts climbing, and a few weeks later it goes wild. It goes to $500 and then to $1000 and then to $2000 a coin. Suddenly, you have $40,000 worth of coins, and that's 40% of what you owe. You go to your bank and tell them about those 20 coins. The bank is all smiles. "Don't worry about your debt," says your banker, "We'll work it out. You know with 20 gold coins you're in an entirely different position. You're a rich man. As a matter of fact, I believe that we can go quite a bit further on your loan!"

Now translate that little story into international bankers' language, and you have the makings of an interesting concept. The concept is simple and fundamental: the bigger the collateral, the more you can borrow. Here's a second concept. As your assests grow bigger, your debts look and feel smaller. And that's exactly what's happening to the gold-owning nations as the price of gold rises.

Now here are some interesting statistics. The Communist countries own about 230 million ounces of gold. The Free World owns about 1.2 billion ounces of gold. The US owns the single largest hoard of gold, about 265 million ounces. Idiotically, the US values its gold holdings at 42.20 an ounce. But suppose the US decides that instead of fighting gold, it's going to use gold. In fact, it decides (or realizes) that gold is its "savior." The US then announces that it stands ready to buy or sell gold at $1000 an ounce. That would mean that the US hoard would immediately be worth $265 billion dollars. Since the US Federal debt is now nearing $900 billion, the US would then have one dollar of gold for every $3.4 in Federal debt, not a bad ratio.

In fact, with that much of its assets in gold, the US could undoubtedly greatly expand the paper side of the ledger; it could increase its borrowing all over again.

Can all this occur? On the minus side is the fact that almost all politicians are ignorant about gold, and almost all politicians are therefore afraid of gold. On the plus side is the fact that any nation that continues to borrow at increasingly high rates must eventually destroy itself. Using high priced gold to raise reserves is actually an irresistable idea (once you understand it). I've often said that a government will use any means at its disposal–to perpetuate itself. Utilization of gold will, in the final analysis, help the US Government to perpetuate itself.

GOLD, SILVER: The bull-bear count for gold over the past month was 91% of the advisories bullish on gold. This represents too much optimism, and therefore I look for possible near-term trouble (this "trouble" should get rid of some of the bulls).

The weakness was probably best seen in gold's reaction to the outbreak of the Iraq-Iran hostilities. When the news broke, gold did very little, and it was my own feeling that traders were selling into the news. At another time, when gold was in a strongly bullish cycle, that kind of war news would have run the metal up 20 or 30%. But it just didn't happen this time, and that was the tip-off.

Meanwhile, the ratio of silver to gold, which was about 43 a few months ago, has now dropped to 31. My guess is that silver should move about in line with gold from here on.

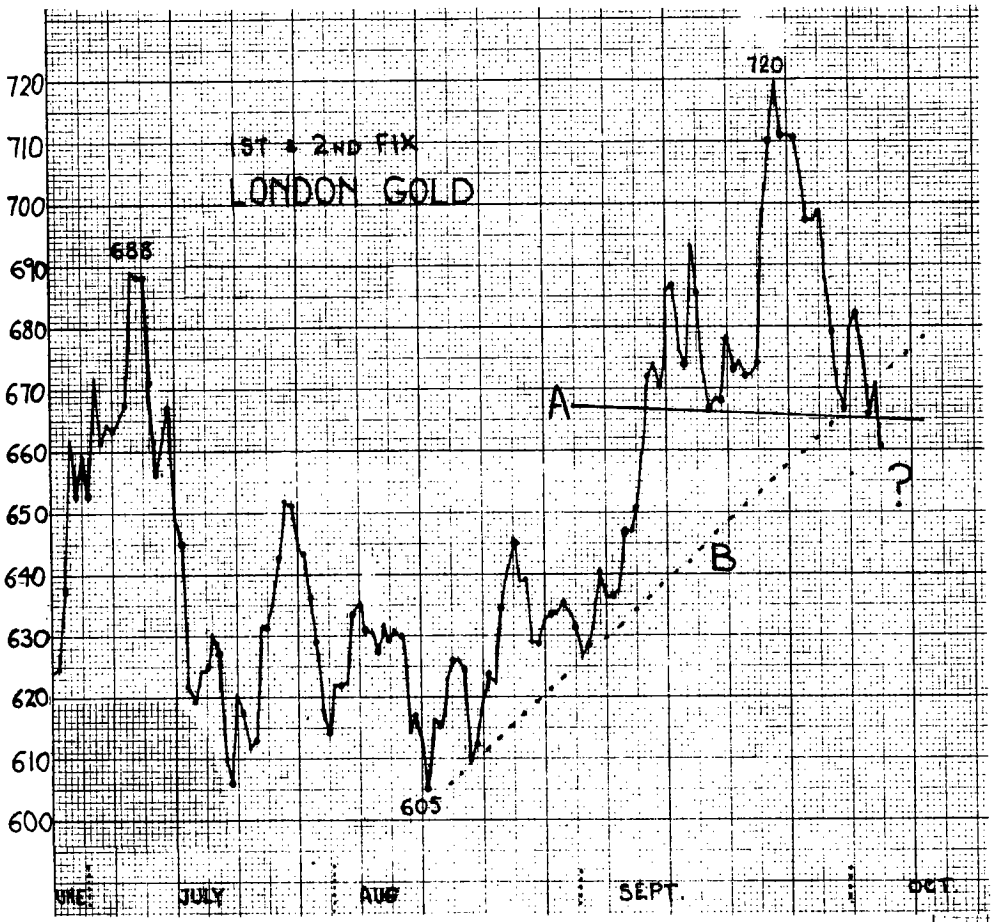
The large page 6 chart of gold traces the first and second London fix over the last four months (two plottings for each day). Last week two support lines were violated. Line A at 665 is the "neckline" of a head-and-shoulder top. This neckline or support line was broken on Friday, October 3, when the second London fix hit 670. At the same time gold broke below a rising trendline that extended from the August low of 605.

These violations provide an interesting test for gold. If the head-and-shoulders top provides a normal downside measurement, I would expect gold to drop back to the 615-620 area. But there should be strong support around 605-610. On the other hand, nothing is sure in technical analysis, and it's possible that the 650 area will support the price. A strong plus in the gold picture so far is the resistance of the gold stocks to decline.

The page 6 Point & Figure chart offers much longer term perspective. This is an 8x24 point chart, which means that each box on the chart is equal to 8 points and only rallies and declines of 24 points or more are shown. I see the pattern as a massive, developing bottom with major resistance at horizontal line C in the 700 area. Near-term support for gold is at trendline D which would offer support on any decline at about 640. Further support is at trendline C at about 580-600.

As far as I'm concerned, the more backing and filling that gold does here, the stronger the pattern. When gold is ready, it should push strongly through the 700-720 area and then quickly test the highs.

Aside from *United Services* (gold) *Fund* and *International Investors*, both funds dedicated to gold shares, there is another gold fund that is little known. This is *Precious Metal Holding Com-*



pany, a $100 million closed end gold fund that now trades on the AMEX (price aroun 27). The fund not only holds many leading gold and silver shares (70% in gold shares), but as of June 30 this fund held 22,000 ounces of gold bullion. The fund is interesting and well worth having, and one of its attractions is that it has been selling below net assets.

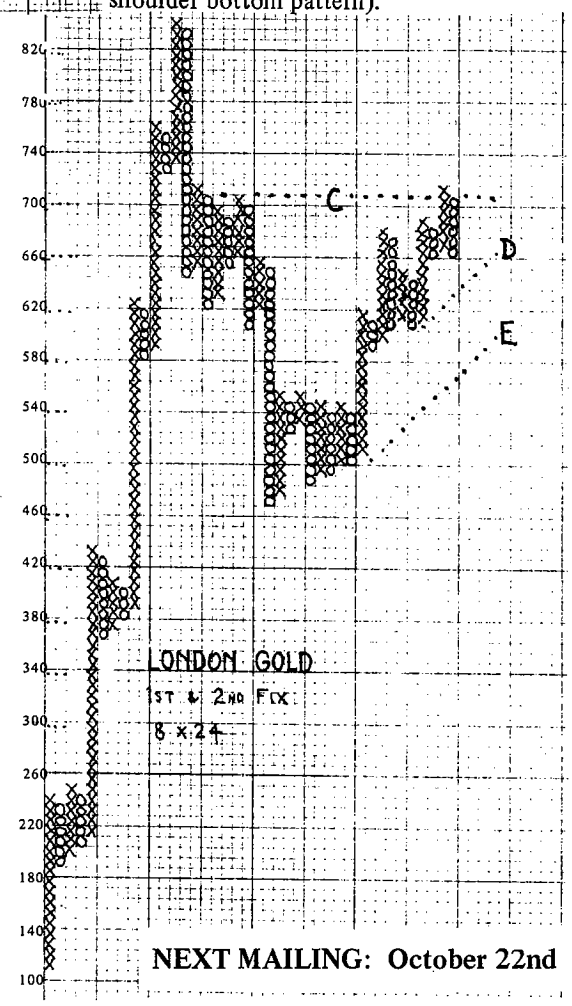
NOTE: I've been asked about various open-end funds that I like. One of the most successful has been *Mutual Shares Corp.,* 170 Broadway, NYC 10038. This is a no-load fund with a superb record. Another fund that offers all sorts of switching facilities (daily income, Municipal bonds, long-term bonds) is *Fidelity Equity Income Fund,* 82 Devonshire St., Boston, Mass 02109 (800-225-6190). As subscribers may have surmised, I believe that the no-load funds, in general, offer huge advantages for the average investor. For instance, one way to work with these funds is to hold the equity funds while the PTI is in a rising trend, switch into a daily income fund when the PTI is in a declining trend.

LATE NOTES: At Friday's close (October 3), the PTI recorded a value of 1326, just one point below its peak of 1327 (recorded on September 22). Any strength this week will take the PTI to another new high. I've said it dozens of times but I'll repeat it – as long as the PTI holds above a rising trendline it's going to drag everything else up with it, even the Dow (which is still lagging badly). As you can see on the page 2 chart, the A–D ratio is also lagging rather badly. So it'll be a fight between the PTI's strength and the weakness in the Dow and the A–D ratio.

FINAL THOUGHTS: Bank debits for the week ending Oct. 3 were down $7.5 billion. I continue to feel that the public is strapped for cash. In California, with mortgage rates now over 14%, the housing market has gone dead. Even in the gold market the public is having trouble buying the merchandise.

I just went through a long and fascinating list of price changes over the past 10 years (1970 compared to 1980). On the high end are: one gallon premium gas up 288%, tuition fee to Queens College, NY up 1436%, a Mercedes-Benz (top of the line) up 350%, one pound of hamburger up 267%. Here are the bargains: Dodger Stadium ticket up 29%, 8-track car stereo set up zero, Vitamin E up 17%, bottle of Tequila (Cuervo) up 2%, Drunk driving fine (LA County) up 10%, D-J Industrial Average up 26%.

THINKING: With new billions of dollars going into the military, somebody has to dream up the new weapons concepts. These are the "Think Tanks" and they're about to get big contracts. Two which are listed are Planning and Research (NYSE) and American Science and Engineering (Amex). They should both do well, as should TRW (which I particularly like in view of its huge head-and shoulder bottom pattern).



NEXT MAILING: October 22nd